No. 71-308

In the Supreme Court of the United States

OCTOBER TERM, 1971

UNITED STATES OF AMERICA, PETITIONER

v.

MARIAN A. BYRUM, EXECUTRIX UNDER THE LAST WILL AND TESTAMENT OF MILLIKEN C. BYRUM, DECEASED

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

REPLY BRIEF FOR THE UNITED STATES

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Respondent and *amici* would have this case decided by reference to the proposition that a grantor who retains only managerial and administrative powers over a trust has not retained "the right * * * to designate" within the meaning of Section 2036(a)(2) of the Code. They ask also that this case be decided under the authority of this Court's 1929 decision in *Reinecke* v. *Northern Trust Co.*, 278 U.S. 339. In so contending, they seek to divert attention from the problems of their own case and to have another decided in its stead. This case is not one involving

merely retained managerial or administrative powers over a trust, and *Reinecke* v. *Northern Trust Co.* would not control decision even if it were.

1. The sole basis for the proposition asserted by respondent and *amici* is set forth in the Tax Court's opinion in *Estate of King* v. *Commissioner*, 37 T.C. 973, upon which they place major reliance (Br. 11-12; *Amici* Br. 9). It is, in short, that the broad discretionary powers retained by the grantor with respect to management and administration of the trust must at all times be exercised in good faith, in accordance with fiduciary standards, and with due regard for the interests of the beneficiaries of the trust. On this basis, it is concluded that the grantor's retained powers are circumscribed by a judicially enforceable objective and external standard, and do not constitute the right to designate.

In reaching this conclusion, the lower courts have not always differentiated between the retention of those powers necessarily conferred upon a trustee, and the retention of additional powers which, for all practical purposes, enable the grantor materially to shift the enjoyment of trust income between current beneficiaries and remaindermen. Thus, it has been held that property transferred in trust is not includable in the grantor's gross estate under Section 2036 (a)(2) even though he may have retained such powers as the power to invest in any type of property, including wasting assets, without the duty to diversify investments, and the powers to determine, in his absolute discretion, whether receipts constituted income or principal, and whether expenses should be

charged against principal or income. See, *e.g.*, *Estate of King* v. *Commissioner*, *supra*; *Old Colony Trust Company* v. *United States*, 423 F.2d 601 (C.A. 1). Although recognizing that, within the bounds established and maintained by courts of equity, grantors have wide latitude in exercising such retained powers, the lower courts have labelled them as merely managerial or administrative powers and, without further analysis, have held them not to make a transfer taxable at death.

We question whether such holdings can always be squared with this Court's decisions in *Commissioner* v. *Estate of Holmes*, 326 U.S. 480, *Lober* v. *United States*, 346 U.S. 335, and *United States* v. *O'Malley*, 383 U.S. 627. In these decisions, remarkably ignored by respondent and *amici*, this Court properly has been sensitive to the mandate of Sections 2036 and 2038, under which property, though beyond the grantor's power to retake, is includable in his gross estate if he has retained control over the actual or immediate enjoyment of the income or principal. This Court has eschewed decision by label, and has instead inquired into the substance of the powers retained by the grantor.

Judged by these standards, and particularly in view of the Court's recognition in *O'Malley* that the power to accumulate income (which might also be described as an administrative power) constitutes the right to designate under Section 2036(a)(2),[1] it is

[1] See *Industrial Trust Co.* v. *Commissioner*, 165 F. 2d 142 (C.A. 1), cited with approval in *O'Malley*, *supra*, 383 U.S. at 631-632.

difficult, if not impossible, to reconcile many of the lower court decisions with those of this Court. To say with regard to the former cases that the power of the grantors to shift enjoyment was limited by their fiduciary duty to act in good faith in the best interests of the beneficiaries does not adequately distinguish *O'Malley*. The power of the *O'Malley* grantor to accumulate would also have to be exercised in good faith in accordance with his fiduciary responsibility, but since the grantor nevertheless has considerable leeway in exercising such a power, which is not subject to any discernible objective limitation, this is enough to support the tax.

2. But whether or not the proposition regarding managerial and administrative powers over a trust would stand the scrutiny of this Court, it has no bearing on the outcome of the instant case. Decedent here retained not merely managerial and administrative powers over a trust, but full control over the affairs of three corporations. Respondent and *amici* in effect are asking this Court to shut its eyes to the fact that, in the proper exercise of managerial and administrative powers, a controlling stockholder has a significantly greater opportunity to regulate the flow of income to trust beneficiaries than a mere trustee. Compare *Commissioner* v. *Sunnen*, 333 U.S. 591, 608-610, with 1 *Restatement of Trusts 2d*, §§ 232, 236(g) (Comment y). The powers of the controlling stockholder are limited only by such duty as he may owe to his corporation and its stockholders as such. If he fulfills that duty, he is not answerable in any court, regardless of the underlying, and pos-

sibly competing, interests of the trust beneficiaries, or the effect that the corporate decision may have upon them. The mere trustee, on the other hand, must exercise his powers exclusively by reference to the needs and interests of the life tenants and remaindermen. There is thus absent here (and in *amici*'s case as well) the sole basis for the proposition which respondent and *amici* press upon this Court—that the trustee's powers are circumscribed by the undivided fiduciary obligation he owes to the beneficiaries of the trust.

If the teaching of *Holmes*, *Lober* and *O'Malley* is to be followed, then surely it means nothing less than that the proposition upon which respondent and *amici* rely (assuming that propositon remains viable) is not to be extended by further labelling. Respondent and *amici* concede as much in failing to undertake to distinguish, or, for that matter, even to cite, any of these decisions.

3. Rather, they prefer to rest their case on *Reinecke* v. *Northern Trust Co.* and its progeny, and insist (Br. 13, 15; *Amici* Br. 10) that a decision for the government in this case would require the overruling of that case. This is incorrect. The governing statute in *Northern Trust* was the Revenue Act of 1921 (c. 136, 42 Stat. 227), under which transferred property could be included in the grantor's gross estate only if he had power to revest the property or the income from it in himself. The government's argument here, however, is founded on decedent's power to shift enjoyment between beneficiaries, a retained power that was made taxable for the first

time by the Revenue Act of 1924 (c. 234, 43 Stat. 253). *Northern Trust*, therefore, provides no comfort for respondent or *amici*,[2]

Nor are they aided by the Court's failure to overrule *Northern Trust* after inviting argument on the question in *Commissioner* v. *Estate of Church*, 335 U.S. 632, and *Estate of Spiegel* v. *Commissioner*, 335 U.S. 701. The Court held for the government in both cases on other grounds, and thus did not find it necessary to pass on the question. Its failure to do so can hardly be taken as an endorsement of *Northern Trust*, as respondent and *amici* would have it (Br. 13-14; *Amici* Br. 6-7). Far more significant, we believe, is the fact that, in the 23 years that have passed since *Church* and *Spiegel* were decided, reference to *Northern Trust* is nowhere to be found in the reports of this Court's opinions.[3]

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[2] *Amici* are confused (*Amici* Br. 10, n. 9) regarding the relationship between *Northern Trust* and the Revenue Act of 1924, which was approved on June 2 of that year. Section 301(a) of the Act made it operative with respect to the estates of decedents dying after the enactment of the Act. Since the *Northern Trust* decedent died on May 30, 1922 (278 U.S. at 343), the 1924 Act was not involved in that case. However, the Act (Section 302(d) and (h)) did have a retrospective feature that did not come into play in *Northern Trust*. It applied to *inter vivos* transfers effected before enactment, but only if the decedent died after enactment. Cf. *Porter* v. *Commissioner*, 288 U.S. 436.

[3] *Northern Trust's* limited relevance under the later statutes had been recognized by the Court long before *Church* and *Spiegel* came on for argument. See *Porter* v. *Commissioner*, 288 U.S. 436, 442; *Helvering* v. *City Bank Co.*, 296 U.S. 85, 88-90; *Helvering* v. *Helmholz*, 296 U.S. 93, 97-98.

In sum, then, we agree with respondent and *amici* that this case calls for application of the doctrine of *stare decisis*. But since *Northern Trust* was decided before enactment of the predecessors of the statutes now in force, it would not be authoritative even if the issue posed were one involving only managerial and administrative powers over a trust. *A fortiori*, it is not a guide to decision where, as here, we are concerned with retained powers over all aspects of corporate operation. The controlling precedents are *Holmes*, *Lober* and *O'Malley*; and they require reversal of the judgment below.

Respectfully submitted.

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